



COMMERCIAL UMBRELLA – STAND ALONE OR FOLLOW FORM?

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ON YOUR TEAM.

A commercial umbrella policy is like third base – we only pay attention to it when we are hurrying home. That’s because we usually have to wait until the primary casualty terms are in place before we can begin focusing on the umbrella – and by then, time is quickly running out!

Anecdotal evidence of this tendency can be found in the typical answer to any question of coverage found in a commercial umbrella – it follows form. Unfortunately, this answer is too often not accurate. A fact that you would rather not discover after a large claim is denied by the umbrella insurer even though it is covered by an underlying policy.

EXCESS, UMBRELLA – A ROSE BY ANY OTHER NAME

The confusion begins with what we name the form (alternately, excess liability policy or umbrella liability policy). An umbrella policy may be described as a specific type of excess liability policy – a policy whose value may be measured by comparing that particular form to the three objectives an umbrella is generally designed to achieve.

As you cannot determine the substance of a book solely by examining its title, similarly the title of the policy form – excess or umbrella – does not reveal the terms of coverage. Titles such as “Excess Liability Protection,” “Commercial Umbrella,” “Commercial Excess Liability Policy “ and “Commercial Umbrella Liability Coverage Form” are commonly used but reveal very little about what is covered by the umbrella policy.

And herein lies a point that is difficult to overstate: it is critical to fully read the umbrella policy (including all endorsements) to determine the terms and conditions that apply. Recognize there is no “standard” umbrella policy – while there are undoubtedly similarities among the forms, the differences are also marked. Given this understanding, the question of what is important to you naturally arises.

THREE OBJECTIVES OF AN UMBRELLA POLICY

It has been generally understood that an umbrella policy has three purposes.

1. **Provide greater limits of liability for any one accident or occurrence.** In other words, when one large liability claim exceeds the limits of the underlying policy, the umbrella provides coverage (subject to the umbrella limits). However, if the umbrella excludes claims that are covered by an underlying policy, this most basic of purposes is unfulfilled.
2. **Provide coverage that is broader than the underlying policies.** However, underlying policies, particularly Commercial General Liability, provide considerably broader coverage than was offered in the past. Therefore, this purpose or objective is usually not realized. In addition, the pricing of umbrella policies does not contemplate known, uninsured exposures. Therefore, it is unreasonable to expect an umbrella insurer to provide coverage for those exposures. Yet, umbrella policies, in certain circumstances, still provide broader coverage than underlying policies. For example, many umbrella policies’ coverage territory is worldwide – most underlying policies provide more limited coverage territories.

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3. **Drop down and provide coverage over an underlying policy aggregate limit that is reduced or exhausted by payment of damages.** To a large extent, most umbrella policies satisfy this purpose, albeit with some important caveats.

WHAT ARE STAND-ALONE AND FOLLOW-FORM UMBRELLA POLICIES?

Umbrella policies can be loosely categorized as either a “stand-alone” policy or a “follow-form” policy.

- A “stand-alone” umbrella policy is characterized by having its own terms, conditions, limitations and exclusions. In other words, the coverage provided by the underlying policies does not affect the umbrella policy. Coverage is determined solely by the wording found in the umbrella policy. **While certainly not conclusive, a “stand-alone” umbrella may be indicated by a multi-page policy form – 10, 15 or even 20 pages, not including endorsements.**
- More A “follow-form” umbrella policy is characterized by incorporating into the umbrella the terms, conditions, limitations and exclusions found in the listed underlying policies. Nonetheless, a “follow-form” umbrella usually states, if different from the underlying, the policy will follow its own terms, conditions and exclusions. For example, a “follow-form” umbrella policy always has some of its own conditions, such as a stand-alone other insurance condition. A common misconception is that a “follow-form” umbrella policy will follow the underlying CGL’s “primary and noncontributory” other insurance condition. **A clue that an umbrella may be “follow-form” is that policy consists of only a couple of pages.**

STAND ALONE VS. FOLLOW FORM — WHICH IS BETTER?

Is a “stand-alone” umbrella better than a “follow-form” umbrella? Ideally, you would like the umbrella form to meet all three umbrella objectives. In which instance, it would not matter how the umbrella form was categorized. However, it is usually not feasible to accomplish all three goals. In which case, the answer depends upon what goals are most important to you. And there are always trade-offs.

For example, finding a pure “follow-form” umbrella policy may be more effective in meeting the first goal of providing limits that are in excess of the underlying policies and avoiding an umbrella coverage denial for most claims covered by the underlying insurance. The trade-off is that you would not have broader coverage in the umbrella and may not have adequate drop-down coverage over an exhausted aggregate limit.

On the other hand, the “stand-alone” umbrella coverage may look to be as broad as the underlying policies, provide adequate drop-down coverage over an exhausted aggregate limit, and provide coverage in a few areas not included in the underlying policies.

The problem with this approach is rooted in the very nature of the “stand-alone” umbrella. It may be difficult, if not impossible, to determine if the umbrella actually is as broad as all underlying insurance. In most cases it is not. “Stand-alone” umbrella policies do not drop down over a sublimit, such as the Damage to Premises Rented to You limit found in a CGL policy.

These limitations of coverage may be offset by your concern with drop-down coverage as well as the few situations in which the “stand-alone” umbrella is broader than the underlying policies, including a broader coverage territory. This may be a trade-off that is important to you.

In either case, one fact is inescapable: until you have read and understand the umbrella coverage that is being offered or purchased, you are not able to thoughtfully consider the tradeoffs.

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CONCLUSION

Most umbrella policies have the characteristics of both “stand-alone” and “follow-form.” In other words, the policies do not fit neatly into either category. The result is that the umbrella may be broader in some instances, but more restrictive than the underlying policy in others, possibly leaving you short of the objectives.

For example, what may initially look like a “follow-form” policy (the insuring agreement incorporates, by reference, the terms and conditions of the underlying policy) may contain so many of its own terms, conditions and exclusions (often by endorsement), that the benefit of “follow-form” is completely lost or substantially reduced.

Further, while most umbrella policies drop down over a reduced or exhausted aggregate limit, an umbrella may provide less coverage when dropping down than the underlying policy would. For example, some umbrella insurers will drop down over an exhausted aggregate limit, but expressly state they do not have a duty to defend any additional claims. Some insurers take the opposite approach, they expressly assume the duty to defend any additional claim that is covered by the umbrella once it has dropped down over an exhausted aggregate. As the duty to defend is a very important aspect of any liability policy, this difference is significant when evaluating the value of the drop-down provision of an umbrella policy.

In sum, understanding the terms and conditions of the umbrella policy as well as your needs are fundamental if you wish to select an umbrella policy that best fits your needs.

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